CORPORATIONS: LIABILITY OF STOCKHOLDERS IN MINING CORPORATIONS TO CORPORATION CREDITORS FOR UNPAID STOCK SUBSCRIPTIONS.—In Rhode v. Dock-Hop Company,[1] some of the stockholders of a mining corporation, which had abandoned its holdings, reorganized the corporation, believing that the properties were valuable, and purported to sell the property to themselves as the incorporators of the new corporation, at a price far in excess of what the properties were worth. The new corporation became insolvent, and a suit was brought by the creditors of the corporation against the individual stockholders. The same issue of law has since been presented in *Zurath v. Claggett.*[2]

Under the provisions of the Constitution of California and the California Civil Code, the stock of a corporation can be issued "only for money paid, labor done, or property actually received."[3] In construing the above words the Supreme Court of California has held that, although stock is issued as fully paid up, it does not "estop" or bind the creditors of the corporation, and in such a case, if it is not actually fully paid up, the creditors may prove the fact in court and secure a sufficient portion of the unpaid capital stock to satisfy the debt.[4] The same liability as to original subscribers attaches to transferees where the latter have caused the transfer to be entered on the books of the corporation.[5]

So far as the rights of the corporation's creditors are concerned, there is no essential difference between an exchange of fully paid stock for property of a known value, as in the principal cases, and a sale of such stock for cash at less than par value.[6] The stockholder's obligation is absolute even though the corporation has in selling the stock accepted a qualified liability, and has "estopped" itself from enforcing payment of the balance.[7] Where, however, the creditor knows of the facts surrounding the issuing of the stock fully paid up for property of a known overvaluation, he cannot insist on the payment of such difference.[8]

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thereupon vested, and that the failure of defendant to make complete delivery amounted to a conversion of the undelivered portion, in which case the plaintiff had the right to waive the tort and sue on an implied contract, or if, perchance, the undelivered portion had no existence, that there would be grounds for an action for money had and received. Inasmuch as in either case the action would be one of the common counts, it follows that under the code provision an attachment should lie. The dissenting opinion is based, therefore, upon a different analysis of the action and not upon a different construction of the code section.

[1] (1919) 30 Cal. App. Dec. 47, rehearing in Supreme Court of California granted November 24, 1919.

[2] (February 5, 1920) 31 Cal. App. Dec. 406.

[3] Cal. Const., Art. XII, § 11; Cal. Civ. Code, § 332.

[4] Herron Company v. Shaw (1913) 165 Cal. 668, 133 Pac. 448, Ann. Cas. 1915A 1265; Sherman v. Harley (1918) 56 Cal. 98, 174 Pac. 901; Llewellyn Iron Works v. Abbott Kinney Co (1916) 172 Cal. 210, 155 Pac. 986; 6 California Law Review, 463.

[5] Perkins v. Cowles (1910) 157 Cal. 625, 108 Pac. 711, 137 Am. St. Rep. 158, 30 L. R. A. (N. S.) 283; supra, n. 1.

[6] Herron Company v. Shaw, supra, n. 3; See v. Heppenheimer (1905) 69 N. J. Eq. 36, 61 Atl. 843; 1 California Law Review, 540.

[7] Vermont Marble Co. v. Declez Granite Co (1902) 135 Cal. 579, 67 Pac. 1057; 2 California Law Review, 239; Note 8 L. R. A. (N. S.) 271.

[8] Sherman v. Harley, supra, n. 3; 6 California Law Review, 463.

The court in the principal case applies the general doctrine which has been briefly outlined in the above paragraph, even though an issue of stock for mining property was involved. The defense was based on the decision of Judge Sawyer in In Re South Mining Company,[9] where the court held that mining corporations in California are *sui generis*.[10] The doctrine of that case was one of expediency and was limited to mining corporations.[11] It allowed the promoter of a mining corporation to place as large a valuation on a mining claim as was necessary to interest capital and to secure sufficient funds with which to develop the properties, so long as the valuation was fair and reasonable as to subscribers. The court took the position that no one in fact subscribed for any particular amount of stock, or expressly contracted, or intended to contract, to pay the nominal amount expressed in his certificate of stock, or supposed that he had so contracted, by implication or otherwise. And if the creditors were allowed to recover, in the opinion of Judge Sawyer, it would "place the liability of all stockholders in the vast number of mining corporators in this state [California] upon a basis entirely different from that upon which they supposed they stood at the time they became stockholders."[12]

The courts have not been inclined to extend the doctrine of the South Mountain case. It was held inapplicable in Herron Company v. Shaw, where it did not appear from the record that the property received by the corporation was to be used for the purpose of mining precious metals.[13] The South Mountain case was not followed in Vermont Marble Co. v. Declez Granite Co., where it appeared that the stock of the mining corporation was issued for cash at less than par value.[14] All doubt as to a possible distinction between such a situation and the situation in the South Mountain case, where the stock was issued as fully paid up in exchange for an undeveloped mining claim, seems to have been

[9] In Re South Mountain Mining Co (1881) 5 Fed. 403; affirmed (1882) 14 Fed. 347.

[10] Supra, n. 8; see 14 Fed. 347, 349. "They are organized," Judge Sawyer said, "and carried on upon principles wholly different from banking, railroad, insurance, and like commercial corporations having a *subscribed* capital stock. There is no agreement, express or implied, to pay up any particular amount of stock, and no one understands that there is. Certainly none is intended by the parties. If there is a contract to pay up the full normal amount of the stock it could be called in from time to time without regard to the liabilities or needs of the corporation."

[11] In Kelly v. the Fourth of July Mining Co. (1898) 21 Mont. 291, 335; 53 Pac. 959, 969, the court said that there is no reason why incorporators of mining companies should be permitted "to deliberately deceive the public" by overvaluing mining properties, while the incorporators of manufacturing enterprises may not, just because the market value of a mine is not easily determinable, for mining prospects have a market value inasmuch as they are salable and are sold. See v. Heppenheimer, supra n. 5, holds that the amount of fully paid up stock issued in return for mining property should be no greater than that which the corporations would be willing to pay for the properties in cash.

[12] Supra, n. 8; see 14 Fed. 347, 350.

[13] See Herron Company v. Shaw, supra, n. 3.

[14] Vermont Marble Co. v. Declez Granite Co., supra, n. 6.

at last laid at rest in Zurath v. Claggett,[15] where, as in the Vermont Marble Co. case, the stock of the mining corporation was issued for cash at less than par value. The court said explicitly that the Vermont Company case repudiated the doctrine of the South Mountain case. In the principal case, as in the South Mountain case, fully paid up stock was issued for over-valued property. In commenting on the latter decision, the court said that "the entire social fabric," at least in California, has changed since that decision.[16] *C. O. H.*

LEASES: ASSIGNMENT: STOCKHOLDER'S LIABILITY: LIMITATION OF ACTION.—Although it frequently renders section 3, Article XII, of the Constitution[1] nugatory, Hunt v. Ward[2] settled the law of this state to the effect that the statute of limitations begins to run in favor of stockholders on their statutory liability for corporate debts from the time the liability was incurred by the corporation, and not from the time the cause of action accrues against it. Based on section 359 of the Code of Civil Procedure,[3] which may never have been intended by the framers to produce such a result, the case has been reaffirmed many times since.[4]

It is rather surprising that no attempt has been made to amend the statute. Perhaps the decision is in accord with public feeling on the matter. Yet, strangely enough, an amendment to section 322 of the Civil Code permitting the incorporation of limited liability companies was submitted to a referendum in 1918 and rejected by the people. Or perhaps it is a "curious commentary upon our legislative methods."[5]

The harshness of the doctrine lies in the fact that the statute may run in favor of the stockholders before the cause of action has accrued. Thus, where one leases property to a corporation, for every day that the lease runs beyond three years, the lessor loses his right in advance to hold the stockholders. He may refuse to give a lease for a longer period than three years, but from a practical standpoint, there is not much consolation in that.

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[15] (Feb. 1920) 31 Cal. App. Dec. 406.

[16] Supra, n. 1; 30 Cal. App. Dec. 47, 53.

[1] "Each stockholder of a corporation, or joint-stock association, shall be individually and personally liable for such proportion of all its debts and liabilities contracted or incurred, during the time he was a stockholder, as the amount of stock or shares owned by him bears to the whole of the subscribed capital stock, or shares of the corporation or association."

[2] (1893) 99 Cal. 612, 34 Pac. 335, 37 Am. St. Rep. 87. See 28 American Law Review, 907 and 29 American Law Review, 109 as to the comment the case caused at the time it was decided.

[3] "Ths title does not affect actions against directors or stockholders of a corporation, to recover a penalty or forfeiture imposed, or to enforce a liability created by law; but such actions must be brought within three years after the discovery by the aggrieved party of the facts upon which the penalty or forfeiture attached, or the liability was created."

[4] Wells v. Black (1897) 117 Cal. 157, 48 Pac. 1090, 59 Am. St. Rep 162, 37 L. R. A. 619; Gardiner v. Royer (1914) 167 Cal. 238, 139 Pac. 75; Chambers v. Farnham (Feb. 6, 1920) 59 Cal. Dec. 167.

[5] 7 California Law Review, 346, 349.